THE NATION'S MOST COMPREHENSIVE AND EXPERIENCED PROVIDER OF WORKERS COMPENSATION INSURANCE INFORMATION AND TOOLS

NCCI Holdings, Inc. Corporate Fact Sheet

NCCI Holdings, Inc., based in Boca Raton, Florida, is the oldest and largest provider of statistics and employee injury data for workers compensation insurance in the nation.

Operating on a not-for-profit basis since 1922, NCCI studies workplace injuries and other national and state factors impacting workers compensation. NCCI analyzes industry trends, prepares workers compensation insurance rate recommendations, assists in pricing proposed legislation, and provides a variety of data products to more than 900 insurance companies and nearly 40 state governments.

NCCI's core services include:

- Rate and advisory loss cost filings
- Cost analyses of proposed and enacted legislation
- Residual market management
- Production of experience ratings
- Statistical and compliance services
- Maintenance of the workers compensation infrastructure of classifications, rules, plans, and forms

In order to achieve these goals, NCCI works within an alliance of system stakeholders to provide underlying data and identify system trends. NCCI works with regulators, insurers, trade associations, and business, industry, and labor coalitions to maintain a healthy workers compensation system and to reduce the frequency of employee injuries. This often includes providing expert actuarial and economic testimony before state or federal regulatory and legislative groups to support NCCI's analysis and cost estimates.

NCCI also undertakes a variety of special studies and data collection efforts during the year, including:

- Special claims research projects
- Cost analyses of judicial and regulatory decisions
- Monitoring newly enacted laws and regulations
- Partnering with other data mining organizations to ensure a statistically credible database on which to base these analyses

Data Management

Because data is the foundation of virtually all of its activities, NCCI goes to great lengths, in collaboration with state regulators under whose authority some of the data is collected, to maintain the quality and integrity of data—ensuring that it is comprehensive, objective, timely, consistent, and reliable.

As manager of the nation's largest database of workers compensation information, NCCI collects detailed information on up to 50% of the total workers compensation claims and policies filed in the United States. In fact, NCCI annually collects and analyzes:

- Approximately **4.2 million unit statistical reports**—used in experience rating and class ratemaking, this data provides payroll, premium, and loss information by individual insureds for all states in which NCCI is the statistical bureau
- About **2.6 million policies**—we include coverage data that is integral to ensuring the accuracy and timeliness of unit reporting and providing proof of coverage service
- Combined insurer financial information representing about **$25 billion in premium**—this data, which includes premiums, losses, and expenses, is used in the analysis of overall loss cost levels for each state
- Detailed information for approximately **250,000 new claims**—this allows us to

report on trends, perform legislative pricing, and identify recurring injuries and areas of concern
- Residual market financial transactions, representing **approximately $1.3 billion annual written and earned premium**, and **$7.3 billion current loss reserves**, reported by servicing carriers for reinsurance through various NCCI-managed residual market reinsurance pools

NCCI believes that policy makers need the best information to make the best decisions. This also minimizes the potential for undesired and unanticipated consequences. Therefore, NCCI is committed to continuing its work with state and federal authorities and regulators, providing the best available data and injury statistics. NCCI will also continue to make its publications and reports available on **ncci.com**.

Company Background

Users of NCCI's services include insurance companies, state workers compensation insurance funds, independent bureaus, self-insured organizations, insurance agents, regulatory authorities, legislatures, risk managers, workers compensation providers, employers seeking information on their experience ratings, residual market pool service providers and participants, and nongovernmental workers compensation agencies.

A 15-member Board of Directors is responsible for establishing corporate strategy and performance, and acting as a resource for management in matters of planning and policy.

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*For more information on NCCI's products and services or the workers compensation insurance industry, visit **ncci.com**.*

NCCI's Data Collection Capabilities

NCCI has been collecting detailed information on worker injuries and illnesses for more than 80 years. Employing extensive databases, most of which are overseen by state insurance regulators, NCCI prepares state insurance rate recommendations, prices state and federal legislative proposals, and delivers data services and products to more than 900 insurance companies and about 40 state governments.

As manager of the nation's largest database of workers compensation information, NCCI collects and maintains millions of data records on virtually every aspect of workers compensation insurance. Among the types of data collected are:

- Policies
- Proof of Coverage (POC)
- Unit Statistical Reports
- Financial Calls
- Detailed Claim Information (DCI)
- Pool (Residual Market Financial Data)

The annual volume of data we collect allows us to provide statistically significant market information to our customers. Each year, we collect and analyze:

- Approximately **4.2 million unit statistical reports**—used in experience rating and class ratemaking, this data provides payroll, premium, and loss information by individual insureds for all states in which NCCI is the statistical bureau
- About **2.6 million policies**—we include coverage data that is integral to ensuring the accuracy and timeliness of unit reporting and providing proof of coverage service
- Combined insurer financial information representing about **$25 billion in premium**—this data, which includes premiums, losses, and expenses, is used in the analysis of overall loss cost levels for each state
- Detailed information for approximately **250,000 new claims**—this allows us to report on trends, perform legislative pricing, and identify recurring injuries and areas of concern
- Residual market financial transactions, representing **approximately $1.3 billion annual written and earned premium**, and **$7.3 billion current loss reserves**, reported by servicing carriers for reinsurance through various NCCI-managed residual market reinsurance pools

NCCI uses state-of-the-art data collection techniques to process crucial data quickly and accurately. We have developed Internet-based tools for collecting, viewing, editing, and correcting data, which are available to our customers free of charge. An emphasis on technology allows NCCI to provide outstanding service to our customers and improve the timeliness and quality of their data.

Superior Quality

Data quality is an investment that offers its most tangible rewards to the workers compensation system when the most complete and accurate data is provided.

NCCI's continuing quest to improve data quality, adopt the most cutting-edge technology, and open lines of communication with customers has dramatically raised the quality and speed of our data-based products.

Providing "perfect" data is a physical impossibility, but NCCI always works toward that goal. In the process of doing the impossible, we will develop ever more sophisticated tools, increase our level of communication and training and, most important, always keep in touch with the needs of our stakeholders.

Superior Services

Data is the foundation of virtually all of NCCI's activities—superior data ensures the quality of our core services, including:

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- Ratemaking and regulatory services
- Experience ratings and other risk services
- Residual market management

Our data is also used to deliver market information through our wide array of products and services, including Internet-based tools. These services give our customers the important information they need to make intelligent decisions for their businesses.

For more information on NCCI's products and services or the workers compensation insurance industry, visit ***ncci.com****.*

Classification System

The establishment and maintenance of a comprehensive, accurate classification system is essential to the proper operation of workers compensation insurance. Under the current NCCI system, each classification groups together employers that have a similar exposure to losses so that the overall cost of the system is distributed fairly among employers. Each classification is assigned a rate commensurate with its potential for loss.

Subject to certain exceptions, it is the business of the employer (the insured) within a state that is classified and not the separate employments, occupations, or operations of individual employees within the business. Classification based on the business of the employer has the dual advantage of reflecting the liability that has been insured while encouraging loss prevention and safety in a cost-effective manner.

To ensure an equitable distribution of costs, each classification must be both homogeneous and large enough to provide a meaningful statistical base. This, in turn, ensures the integrity of the workers compensation database, which is essential for the pricing, experience rating, law evaluation, and research activities undertaken by NCCI.

Classification Basics

Insureds are classified based on the nature of their business. They are assigned to the one classification that best describes the business of the employer. Each classification includes all of the various kinds of labor typically found in a business. Each legal entity in a state is classified separately.

All of the classifications, with the exception of the Standard Exception classifications (explained below), are called basic classifications. Each basic classification is assigned a four-digit number to describe the business of the employer. Classifications are listed alphabetically in the NCCI-published ***Basic Manual for Workers Compensation and Employers Liability Insurance***. This manual is filed and approved for use in all NCCI jurisdictions as well as several independent rating bureau states.

NCCI also produces two manuals that are not filed but are widely used. The ***Classification Codes and Statistical Codes Manual*** lists all classifications in numerical order and arranges all classifications into 38 main industry divisions called schedules. These schedules are subdivided into 134 groups of classifications having similar characteristics. The ***Scopes® of Basic Manual Classifications*** provides a detailed narrative for each class code along with practical information about the application of each code.

Standard Exceptions

Several occupations are common to so many businesses that special classifications have been established for them. These Standard Exception classifications cover clerical office and drafting employees (including clerical telecommuters); drivers, chauffeurs, messengers, and their helpers; and outside salespersons or collectors (including automobile salespersons). Employees covered by a Standard Exception classification are not included in a basic classification unless the basic classification language specifically includes them.

General Inclusions

Some operations appear to be separate businesses but are included within all basic classifications. Such operations are called General Inclusions and include employee cafeteria operations, the manufacture of packing containers for use in the insured's operations, the operation of medical facilities for employees, printing by the insured of its own products, and maintenance or repair of the insured's buildings or equipment by the insured's employees. These operations are not separately classified because they are a routine part of most business operations.

General Exclusions

Some operations in a business are so unusual that they are separately classified even though they are not conducted as a secondary business. These General Exclusions include aircraft operations, new construction by the insured's employees, stevedoring, sawmill operations, and employer-operated day care services. These operations are classified separately unless they are specifically included within the basic classification wording.

Assignment of Additional Basic Classifications

Although the object of the classification system is to assign the one basic classification that best describes a business, there are some instances when additional classification codes may be necessary. When the basic classification wording instructs users to separately classify certain operations, multiple codes will apply. If the insured performs construction/erection, farming, employee leasing or temporary labor services, or mercantile operations, multiple codes may also apply. Finally, if an insured conducts more than one operation in a state, additional classification codes are allowed.

Classification Dynamics

While insurance and classification theories require the grouping of like or similar employers with common expectations of losses, the classification system is not a rigid, unchanging system. There are two important ways in which the classification system used for workers compensation is continually changing and evolving.

First, each classification combines the payroll and losses of similar employers to develop a price for their protection. The most current five years of data is used for this purpose. The data is updated annually to reflect the most current experience.

Second, NCCI continually monitors and updates the classification system as warranted by evolving business operations. Through invention, discovery, and innovation, industries are constantly refining and upgrading their operational procedures. More efficient manufacturing machines are developed, automation is introduced, raw materials sometimes change, and better assembly methods are devised. These changes potentially affect employees' duties and workplace hazards.

Classification language is updated in a process whereby all class codes are reviewed in a continual cycle. As industry conditions evolve, the experience on which rates are based also changes—tracking with new conditions within the industry—and manual rates are adjusted accordingly.

A properly functioning classification system is necessary for both a fair and equitable distribution of premium needs and for the development of the necessary statistical information to prepare loss costs and manual rates.

The classification system places all employers conducting the same business in the same classification. This reflects the fact that employers engaged in the same business will have similar operations and exposure to loss. The classification system is based on sound insurance theory and is a practical, nondiscriminatory procedure benefiting both the insurance buyer and seller by being cost-efficient while promoting safety and loss prevention.

For more information on NCCI's products and services or the workers compensation insurance industry, visit ***ncci.com***.

Ratemaking: Essential Steps for Ensuring Rate Adequacy

Proper workers compensation ratemaking aims to achieve a simple insurance result—that insurers who write workers compensation insurance in a given state will collect adequate premium to cover the risk, or will at least have adequate loss cost information.

NCCI performs ratemaking functions in more than three dozen states—preparing a full schedule of rates for some states, and in other states preparing data on cumulative loss costs from which individual insurance companies must derive rates by reflecting their own expenses.

The calculations NCCI makes to determine adequate rates start with historical premiums and losses. These historical premiums and losses are restated to reflect interim approved changes in rates and benefit levels, and they are further adjusted to anticipate future loss payments, new trends, foreseeable law changes, or other changes that might occur in a state. The process begins with ensuring the accuracy of existing data and then moves through a series of additional evaluation steps before a final rate is established, as explained below.

Data Validation

All NCCI rates and loss costs are based on actual premium, loss costs, payroll, and loss experience, as reported by the insurance companies. No estimates or scientific samples are used.

Data validation begins with ensuring the accuracy of the reported information. This is a matter of not only receiving the information from insurers, but also of checking and cross-checking that information for accuracy. The data is then subjected to actuarial editing for both reconciliation and consistency.

In reconciliation, the data reported to NCCI is compared with the annual statements and insurance expense exhibits filed with the insurance departments. The goal is to ensure that the competitive tools such as deviations and discounts used by some carriers are not built into a rate structure intended for all carriers. Any suspected errors are reconciled by checking with the insurance company to verify reported results.

NCCI has also constructed a series of data edits to facilitate the examination of the reasonableness of the accident year, calendar year, and policy year information submitted. The information is examined in detail to determine whether losses have changed in a reasonable fashion. NCCI's principal concern is to ensure consistency from year to year among every Call for data.

Assessing Costs

Updating prices means assessing the costs of goods and services and comparing them with the revenue collected under preexisting rates. The product sold by insurers is a promise to pay; the cost of the product is the ultimate value of the losses that occurred during the period for which the promise was made. Insurance is an unusual "product" in that the price must be set before the final cost is fully known.

The essential question in assessing the cost of workers compensation insurance is "how much is needed to pay losses?" In workers compensation, loss dollars pay income continuation for injured workers, and they also pay for medical costs, and vocational and physical rehabilitation. NCCI determines the portion of the premium dollar used to pay benefits by dividing the actual losses by the premium. This provides the actual cost (or loss) ratio.

Determining the projected cost ratio involves adjustments to the premiums and losses underlying the actual cost ratio; these adjustments must account for changes between the historical period and the current period. First, premiums collected under an old set of rates must be adjusted to current levels. Next, because workers compensation payroll is audited to determine the final premium after the policy expires, a premium adjustment is needed to anticipate the ultimate premium that will be collected.

Similar adjustments are also required for losses. To account for recent benefit changes, older loss data is adjusted to the current benefit levels, making the experience reflective of the most recent laws.

The next step, loss development, ensures that collected premium is sufficient to cover all losses, even if the claim is paid out over a number of years. Loss development provides the best estimate of the ultimate liabilities of the carriers for policies written in a given period. While this process can be difficult, NCCI actuaries examine the value of claims over time and constantly review and measure the manner in which losses change, while factoring out variable elements (e.g., shifts in carrier reserve levels).

Trending: Measuring the Acceleration of Costs

In projecting the amount of money needed to provide benefits to injured workers, NCCI analyzes loss experience from past policy periods. The rates being derived, however, must be sufficient to pay losses that will occur in the future. The process used to bridge this time gap is referred to as trending.

In workers compensation trending, a number of factors must be measured. Changes in payroll or wages, which represent the basis for calculating premium, make up one component of the trend. Changes over time in the frequency of claims and in the average cost of those claims comprise the loss or benefit components of the trend. By relating the changes in the benefit components over time to the changes in wages, a trend factor is obtained.

When losses are expected to grow at a slower rate than wages, a negative trend is established; likewise, when losses are projected to increase more quickly than wages, a positive trend is used. If losses and payrolls are expected to change at the same pace, no trend is applied.

Law Evaluation

The final element in establishing the loss component of the rate is an evaluation of future changes in the statutory benefit structures. Many states revise their benefits annually, and each change must be evaluated and a cost estimate determined. Detailed claims distributions reveal, on average, what proportion of each kind of injury has been encountered, what they cost under the old structure, and what they are likely to cost under the new configuration.

Insurer's Cost of Doing Business

In administered pricing states, the next step in establishing adequate rates is to incorporate the insurer's operating costs—the cost of issuing policies, servicing the insureds, providing loss prevention activities, auditing payrolls, settling claims, and defending insureds in disputed cases. Five categories of business overhead expenses are measured: claims adjustment expenses, acquisition costs, general expenses, premium taxes, and profit and contingencies. The amounts needed to pay these expenses are combined, and the amount remaining to pay losses is referred to as the balance point.

In a loss cost environment, NCCI does not address these expense components; instead, the appropriate provisions are determined by the individual insurers.

Putting it All Together

The final step in establishing an adequate rate involves comparing the projected cost ratio—the portion of the historical premiums used to pay losses—to the balance point—the portion of the premium remaining to pay losses after accounting for expenses. If the projected cost ratio equals the balance point, equilibrium is established. The rates are what they should be, and no change is required. If the projected cost ratio is lower than the balance point, rates or loss costs can be reduced; if the projected cost ratio is greater than the balance point, rates or loss costs should be increased.

Once the overall price or loss cost level has been established, it must be distributed to each of the 550-plus individual classifications. Aggregate premium or loss cost level is first distributed among five industry groups: Manufacturing, Contracting, Office and Clerical, Goods and Services, and Miscellaneous. Within each group, the change is further distributed to individual classifications, reflecting the actual loss experience of the classifications. As a result, an overall rate or loss cost level increase of 5% will not necessarily mean that each classification will increase by 5%; some classifications may increase by more than 5%, and, in fact, some classes may actually decrease.

Each NCCI rate or loss cost filing provides our most highly informed actuarial estimate of the needed rate or loss cost level, whether it is an increase or a decrease. When a filing is ready, it is submitted to the state insurance department according to statutory requirements. When revised rates are ultimately implemented, the course on which the state's workers compensation system will be guided is finally set.

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Re: Biographical Information

Barry Llewellyn has been active in the property casualty insurance regulatory arena for over three decades, with a particular concentration in matters involving workers compensation insurance, actuarial, regulatory and legislative issues. Through his employment with NCCI, he has served as Vice President and Actuary-Law Evaluations, Senior Vice President and Actuary and currently as Senior Divisional Executive-Regulatory Services. He was previously employed by Cigna Property and Casualty Group as Assistant Vice President and Actuary and by NCCI as Assistant Vice President and Regional Actuary. Mr. Llewellyn received a Bachelor of Arts degree from Susquehanna University. He is an Associate of the Casualty Actuarial Society, a Member of the American Academy of Actuaries and a member of the National Academy of Social Insurance.